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SEC Enforcement & Venue: A Question of Fairness

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The question never really addressed, but which has always been the fundamental issue, is fairness. When the Commission began shifting its enforcement actions from federal district court to its administrative in-house forum, the bedrock question was fundamental fairness, presented in a series of cases challenging the agency venue selection decisions. When the Appointments Clause issue took center stage in a Supreme Court hearing that concluded with a determination in *Lucia v. SEC*, No. 17-130 (June 21, 2018) that ALJs must be appointed in accord with the dictates of the Clause, the real issue was still fairness. When the President executed an Executive Order eliminating civil service protections for SEC ALJs and making them directly accountable through the political process, the question remained fairness. As the Commission implements the letter of *Lucia* by essentially restarting the administrative enforcement process for pending cases, the question remains one of fairness. That question is still to be addressed.

There is no doubt that the differences between the administrative and federal court forum is significant – otherwise the agency would not have shifted. The administrative action begins with the agency deciding an enforcement case should be brought and charging those involved with wrong doing in an administrative complaint or Order Instituting Proceedings. The hearing has been before a Commission employee known as an Administrative Law Judge under Rules which, until recently, permitted virtually no discovery other than a document exchange despite the fact that the Enforcement staff-prosecutors have had the benefit of a years long investigation. At the hearing, there were no real rules of evidence. Written statements that cannot be cross-examined and hearsay which suffers from the same problem was admissible.

On appeal, the agency that issued the charges decided the ultimate liability and sanction. And, when the case finally reached an Article III federal circuit court, the Commission claimed deference to its decisions, negating any real review by the court.

In contrast, in a federal court civil injunctive action the Federal Rules of Civil Procedure provide for extensive discovery to ensure the development of the facts by all parties. The Federal Rules of Evidence ensure that only reliable factual information is admitted into evidence and that the right to cross-examination is preserved. The trial is presided over by a federal district court judge with lifetime tenure to free him or her from the political processes. Facts are determined by the court or the jury at the election of the parties. Appeals are to a federal circuit court of appeals – no deference to the agency is due.

These fundamental differences, played out in the context of specific enforcement actions that could well end a business and career, spawned the fairness issue in a series of cases challenging the venue selection determinations of the agency. *See, e.g. Hill v. SEC*, No. 1:15-cv-1801, 2015 WL 4307088 (N.D. Ga. June 8, 2015)(raising constitutional issues regarding fairness of forum selection re enforcement action); *Duka v. SEC*, No. 15 Civ. 357,2015 WL 1943245 (S.D.N.Y. April 15, 2015)(same). Over time those claims came to include the Appointments Clause issue ultimately decided by the Supreme Court in *Lucia*. *See, e.g., Bandimere v. SEC,* 844 F. 3d 1168 (10th Cir. 2016) (Appointments Clause violated); *Raymond J. Lucia Companies v. SEC,* 832 F. 3d 277 (D.C. Cir. 2017)(Appointments Clause not violated).

The Commission did not address the fundamental fairness question on which these and other cases were bottomed when responding to the onslaught of cases or even in the Supreme Court. To the contrary, the agency typically defended by focusing on procedural issues, arguing that there was no jurisdiction for a federal district court challenge to its procedures. When the challenges were raised in an administrative context, the Commission denied the claims and argued that the Appointments Clause had not been violated as it did in *Lucia* before the D.C Circuit.

When *Raymond J. Lucia Companies* filed a Petition for Certiorari, the Commission found itself on the other side of the Appointments Clause issue, apparently as a result of the Solicitor General's position. The Solicitor General filed a brief supporting Petitioner's claim that the Appointments Clause had been violated, contradicting the argument the agency had repeatedly made. The brief also urged the High Court to consider a question presented by *Free Enterprise Fund v. PCAOB,* 130 S.Ct. 3138 (2010). There the Court found that the two layers of employment protections afforded PCAOB members violated the Vesting Clause of the Constitution by interfering with the control of the President over political appointees. Commission ALJs, as civil servants, were protected by similar provisions passed by Congress in an effort to reassure the public that the administrative in-house adjudication process was fair because it was insulated from the political process as Justice Breyer noted in his separate opinion in *Lucia*. The Court declined to consider the question.

Now the Commission is complying with the dictates of the Supreme Court's decision in *Lucia*, directing that Petitioner, who battled for years seeking fundamental fairness, be given a new hearing not in federal district court but before a properly appointed ALJ despite his repeated claims of unfairness regarding the venue. The irony, of course, as noted by the Justices during oral argument in *Lucia*, is that despite arguing about the unfairness of the administrative form, Mr. Lucia and his firm will now be subjected not just to the same forum, but one which is directly accountable to the political processes because an executive order stripped SEC administrative law judges of their civil service protections. *Executive Order Exempting ALJs from Competitive Services* (July 10, 2018).

To say that Mr. Lucia, and those who litigated for years in an effort to bring fundamental fairness to the enforcement process, got far less than they bargained for is perhaps the ultimate understatement. Law 360 recently characterized the Commission's implementation

of *Lucia* as "Largely for Show" (Sept 8, 2018). *See also In re Administrative Proceedings,* (SEC Order) August 22, 2018 (order implementing *Lucia*). Yet for Mr. Lucia, and others who have fought for years to bring fairness to the process – those covered by the SEC order and others whose cases have concluded but were subject to the forum shift trend – the fairness question remains unaddressed.

Now is the time for the Commission to step-up and be a leader in the effort to instill a new fairness in the administrative enforcement process. That begins with a recognition that not every case can effectively be adjudicated in an administrative forum. Some cases, for example, may require extensive discovery by those charged; some cases may need the rigors of the rules of evidence; and some cases may be fact intensive, requiring a jury to hear the case. Others may require securities expertise from the trier of fact of the type possessed by ALJs. One size does not fit all.

One way to address these issues is to change the administrative litigation track. Specifically, the agency could, by seeking legislation or through rules, adopt a process similar to one used by FERC. There, following an administrative hearing, the appeal goes not to the agency that brought the charges but to a neutral federal district court. If that process is used, and the proceedings before the district court are *de novo*, it would preserve for the Commission the right to select the venue and use administrative proceedings as deemed appropriate while giving those charged the option to pursue a full federal district court proceeding if they deemed appropriate.

While only a small fraction of those charged might elect to pursue a district court hearing, adopting this procedure would do much to end the claims of unfairness. By specifically addressing the fairness question and acting to instill a new sense of fairness in the enforcement process the agency would be acting as a principled leader, committed to integrity in the enforcement process. Stated differently, adopting this type of process, or something similar, would be a win win – those involved in the process would no longer be able to argue a lack of fairness while the Commission would preserve all of its enforcement options.